ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA

Statement of Joe Kennedy – ICBA
Farm Credit Administration Public Hearing
"Serving Young, Beginning and Small Farmers"
Kansas City, Missouri
November 13, 2002

Thank you, Chairman Reyna for having the FCA board conduct this public meeting today on serving young, beginning and small (YBS) farmers and ranchers and their agricultural credit needs. We are making several recommendations today that will be incorporated into our written response to FCA's Advance Notice of Proposed Rule Making (ANPRM) by the December 23rd deadline.

My name is Joe Kennedy and I'm the President and CEO of the First National bank in Frankfort, Kansas. We're a small agricultural bank. I also serve on the Agriculture-Rural America Committee for the Independent Community Bankers of America. ICBA, as the only national trade association exclusively serving community bankers, is the leading voice for the nation's community banks.

This is an extremely important matter as our rural population grows older and the ages of our farmers increase. We need to look for ways to bring new farmers into the business if we have any hope of slowing or stopping the trend towards fewer and larger farms.

Today I want to briefly discuss the nature of the problem from a community bank perspective and then give you a few of our recommendations.

Nature of the Problem

Mr. Chairman, regardless of the claims, if you travel the country talking to community bankers and ask them – "is FCS serving YBS farmers in your market?" you would get a resounding "NO!".

Instead, what we find is that typically the community banker takes the risks on these farmers. For example, the community bank helps the farmer get started and sees they are doing a good job milking 50 cows. They work with the producer, putting in substantial staff time and several years of effort and help the producer grow his operation to where he is milking 300 cows and has built up considerable equity. Then the FCS comes along and engages in predatory pricing and steals the customer away – even though they weren't there for the customer during the early years of struggle. The FCS can do this because they pay few taxes and have a lower cost of funds – GSE advantages that community banks don't have.

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So what we're seeing is the community bank taking the risks with the YBS farmers and the FCS focusing on cherry picking the best customers, including the former YBS farmers once they become more profitable. We are not talking about competitively pricing loan products here. We are talking about pricing loans well below the market rates for the loan product in an effort to steal away customers. I ask you – what purpose does this cherry-picking serve for the agricultural industry?

What this scenario – which is played out every day all over the country – suggests is that FCA's YBS regulations need to also be combined with regulations placing constraints on the FCS to prevent cherry picking and predatory pricing activities.

Congress put into statute a mandate to serve YBS farmers, but they also put into statute a mandate against predatory pricing. ***They are opposite sides of the same coin.*** The FCS engages in predatory pricing of well-established farmers because that's where they see the profits and because the FCA doesn't regulate against predatory pricing. If FCA did regulate to constrain predatory pricing, then FCS would be forced to focus more efforts on serving YBS farmers – so these issues are intertwined. Constraining predatory pricing will help your efforts to enhance service to YBS farmers.

Yes, the FCS' representatives suggest they are adequately serving YBS farmers, but local bankers would disagree. USDA studies suggest FCS is not addressing the issue adequately and the GOA report recommends specific standards and better documentation as well as public disclosure.

Recommendations - Responding to ANPR Questions

Mr. Chairman, you've asked basically three questions in the ANPR. **One**, what type of guidelines should FCA use? **Second**, how should FCA measure FCS performance? And, **third**, should FCA publicly disclose the results of examinations on YBS compliance?

We believe the initial focus has to be on the second question – how to measure YBS service. Because unless you properly define what you mean by the YBS categories and unless you have accurate data on YBS performance, *everything else you do* will be quite futile.

FCA YBS definitions are too lax

We believe the FCA has relaxed the loan YBS definition far too much by removing the requirement that applicable loans have to be tied to those who are primarily responsible for the executive management decisions. It is simply too lax to only require the loan to have some "benefit" to a young, or beginning farmers or someone who may have only a miniscule ownership interest in the farming entity.

Tie Definition To Actual Managers

We recommend FCA return to the previous requirement tying application of the YBS definition to those who are primarily responsible for executive management decisions. Otherwise FCA is authorizing *a major loophole that obviously allows FCS to suggest they have increased YBS loans when the reality is that you've simply loosened the definition*.

More Clearly Define YBS Categories

We believe the primary purpose of YBS measurement criteria should be to identify small loans made to young and beginning farmers. That is what we need to encourage in agriculture for the future. Therefore, the **Small** farmer category should be the umbrella category that only includes the **Young** and **Beginning** farmer categories for purposes of *this* program.

If you wanted to establish *a separate **Small** farm category* for loans that don't go to young and beginning farmers, then you could do so, but the data shouldn't be reported as part of the YBS program. This would prevent, for example, counting loans to 65 year-old retired and part-time farmers as YBS loans. We suggest *a separate **"Non-YB Small"** category* to account for loans to small farmers who are not young and beginning farmers. T*he focus of the YBS program needs to be on young and beginning farmers, who will, by their nature, also be small farmers.* This approach would be consistent with the intent of Congress and is where we need to focus in terms of bringing more young people into agriculture.

Prevent Double or Triple Counting of YBS Loans

Tied to this issue is that current FCA directions to FCS institutions state "each loan may be reported in more than one category." This, in effect, allows the double or even triple counting of loans for these categories and distorts the numbers that FCS reports because the same loans are being counted more than once.

As the GAO stated in its report, "The totals for loans provided to YBS are not mutually exclusive, and depending on characteristics, a borrow may be counted in two or even all three categories."

If the YBS program is to be credible, then it should not allow for double and triple counting or at least also have **a combined category**, in addition to the separate categories, where double or triple counting of loans is not allowed. The combined category would report small farm loans to young and beginning farmers as a single category instead of breaking all three of these out separately. If you want to break categories out separately and double or triple count loans, that should be clearly stated in the information reported to the public and, as stated, a separate combined category should be used that does not count loans more than once. Otherwise, the YBS data lacks the credibility necessary for a GSE that is uniquely competing in the retail sector, which requires greater accountability.

Accurately Report Father/Son Combinations

Another definitional issue is that FCS can count loans made to the father if the son is also working on the farm and has less than ten years experience. If the father is the primary manager, is sixty years old, and the son simply works on the farm, is this really a young, beginning farmer loan? There should at least be a category that states this is a ***"YB-Other"*** loan to show that it is also largely outside the "YB" category.

Modify Beginning Farmer Definition

We also ask FCA to limit the category of "Beginning" farmers to between *0 to 5 years*. If someone has been in farming a decade, they're not really a beginning farmer.

Aggregate Dollar Amounts of Multiple Loans to Individuals

Regarding the definition of "Small", FCA needs to *aggregate the dollar amount of multiple loans to the same individual* so that two $250,000 loans don't count as two YBS loans. Also, loans less than $5,000 should not be included in the totals since they are not likely to contribute in a significant way to operating a full-time farm. For example, a farm with $500 of sales should not be counted, but current FCA rule appear to allow this, even though USDA loosely defines a farm as producing $1,000 annually in agricultural sales. Therefore this would modify the smallest category by changing the size from "0 to $50,000 to "$5,000 to $50,000".

Distinguish Between Full-Time and Part-Time Farmers

Finally, in terms of definitions, we believe FCA should consider the net worth and total assets of the producers receiving these loans and determine if the producers are full-time farmers or part-time and hobby farmers and whether their main income is from farming on non-farming activities. *YBS should not include hobby farmers or part-time farmers who primarily depend on non-farm jobs*. Earning a majority of income from off-farm sources should disqualify producers as YBS.

Part-time producers should be counted in the new category we recommended above – the **"Non YB Small" category** and this category should be broken out to distinguish between full time small farmers and part-time farmers who are not young and beginning farmers.

Again, Mr. Chairman, if you do not adequately define the YBS categories and breakout the data correctly, then the data can be manipulated to say almost anything and the reported YBS data will prove inconclusive and labeled as not credible.

Reporting

Report Data Annually & On Individual FCS Institution Basis

Reporting of examination results should be available on an individual FCS institution basis, not just aggregated and sent to the District banks. The individual institutions should also be required to make their YBS program publicly available. The reporting results should be available to everyone, not just FCS shareholders, since the FCS is a GSE and should be publicly accountable.

FCS data already reports YBS loans by percent of FCS's overall portfolio and volume of loans, but this information needs to be individualized, available to the public, and with definitions that are credible.

Make Examination Results Publicly Available

All of this data could be placed into a single table in the institution's annual report and the data should be made available to the public, over the internet and through the mail upon request. FCS institutions should be required to report this information annually.

Demographic Studies

FCA asks whether FCA should require FCS to conduct demographic studies on YBS farmers. Any studies of this type would more appropriately be handled by independent researchers, such as universities and the Extension Service professors with no financial ties to FCS institutions.

Predatory YBS Lending

Implement Regulations Prohibiting Predatory Pricing

FCA asked whether FCS should give concessions or special credit treatment, lower fees or rates to YBS farmers. This smacks again of engaging in predatory pricing and should be avoided. The government already provides loan guarantees under special terms for these farmers and the FCS can use these programs just as community bankers can.

Meaningful Guidelines

YBS Performance Rating System

FCA has stated the objective in the ANPR to develop clear meaningful and results-oriented guidelines for System YBS policies. FCA has asked whether they should institute a YBS performance rating system.

While this may be a worthy objective, we want to emphasize that without adequate definitions as stated above, the value of any potential "guidelines" FCA develops will be insignificant. If the definitions are insufficient, then the value of guidelines are debatable since their effectiveness will be driven by the definitions FCA uses.

Enhancing the OFI Program

Improve OFIs But Don't Unduly Burden

FCA asks about using outreach activities and more effectively using OFIs. We suggest the FCA direct FCS institutions to come up with a program that would encourage the formation of more OFIs.

ICBA would oppose attempts by FCA or FCS to further burden the OFI program especially since the OFI program has been allowed to deteriorate, contrary to the intent of Congress. Commercial banks with OFIs already comply with numerous regulations and CRA. Banks don't establish OFIs for the purpose of CRA and YBS lending, rather, they establish OFIs as a funding source for agricultural credits. Suggesting that commercial bank OFIs should also have a YBS component, when the parent commercial banks already have numerous regulatory compliance burdens, ends up discriminating against OFIs. OFIs, even though they pay capital into the Farm Credit System, are already discriminated against because they are not treated as equal partners, with equal pricing, board representation, and the same capital treatment as FCS institutions receive.

FCA's goals, again, should be to enhance the OFI program and therefore, FCS institutions should have to comply with an outreach program to establish OFIs with specific guidelines, similarly to they type of regulatory reforms FCA is contemplating for the YBS program.

Conclusion

Mr. Chairman, I want to emphasize we truly appreciate FCA's efforts to look into YBS performance, standards and reporting. It's important to look at this sector of American agriculture. What we want are some meaningful definitions and credible data so we have an accurate look at what is really happening. Obtaining accurate data through unambiguous definitions will provide FCA with a starting point to clarify future courses of action for the YBS program. We look forward to submitting written comments to FCA's ANPR and in working on this issue further with the FCA board.

As I stated in my initial comments, we believe FCA needs to broaden this inquiry by considering some meaningful predatory pricing constraints, since this is the flip-side of the coin in terms of encouraging a stronger focus on the YBS program. In addition, equal attention should be paid to enhancing the OFI program and requiring outreach efforts by FCS institutions to establish more OFIs. Thank you.

SUMMARY OF ICBA RECOMMENDATIONS

FCS Young, Beginning Small (YBS) Program

Address Predatory Pricing or "Cherry-Picking" Issue

- **Implement regulations prohibiting predatory pricing as Congress intended**
- **Addresses flip-side of YBS issue & places focus on YBS farmers**

Accurately Measuring YBS Performance – Definitional Issues

- **More clearly define YBS categories & intent**
- **Prevent double or triple counting of YBS loans**
- **Establish a mutually exclusive "Combined YBS Category"**
- **Accurately report father/son combinations**
- **Modify beginning farmer definition**
- **Aggregate dollar amounts of multiple loans to individuals**
- **Distinguish between full-time and part-time farmers**

Accurate Reporting of YBS Data – Reporting & Disclosure Issues

- **Make examination results publicly available**
- **Report data annually from each institution**
- **Report data individually from each FCS institution**
- **Aggregating data @ Farm Credit Bank level is insufficient**

Meaningful Guidelines

- **FCA seeks clear, meaningful & results-oriented guidelines**
- **Definitions will drive effectiveness of any such guidelines**

Requiring FCS To Similarly Enhance OFI Outreach

- **Commercial banks already comply with CRA and numerous regulations**
- **FCS needs to similarly measure system's OFI outreach efforts**
- **New FCA OFI regulations should address evolving need for enhanced OFI program**
- **These OFI regulations should be finalized in tandem with new YBS regulations**